

**BEFORE THE
ILLINOIS COMMERCE COMMISSION**

Illinois Bell Telephone Company)	
)	ICC Docket No. 02-0864
Filing to Increase Unbundled Loop)	
And Nonrecurring Rates (Tariffs filed)	
December 24, 2002))	

***** PUBLIC VERSION *****

**TESTIMONY OF ROBERT P. FLAPPAN
ON BEHALF OF
AT&T COMMUNICATIONS OF ILLINOIS, INC.**

AT&T Ex. 4.0

May 6, 2003

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1 **I. INTRODUCTION AND QUALIFICATIONS**

2 **Q. PLEASE STATE YOUR NAME AND ADDRESS.**

3 A. My name is Robert P. Flappan. My business address is 11020 W. 122nd Street,
4 Overland Park, Kansas 66213.

5 **Q. BY WHOM ARE YOU EMPLOYED?**

6 A. I am employed by AT&T Corp. as Regulatory Affairs Director.

7 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND.**

8 A. I received a Bachelor of Science Degree in Business Administration, with honors,
9 from the University of Missouri-Kansas City in 1981. I received a Master of
10 Science Degree in Business Administration (“MBA”), with honors, from the
11 University of Missouri-Kansas City in 1983. I am currently pursuing, and have
12 completed 30 hours towards, a Master of Science Degree in Telecommunications
13 at the University of Colorado. In addition, I have attended USTA Separations
14 Training, the Crosby Quality College, the Brookings Institution course on
15 Business and Public Policy, Bellcore courses on the Switching Cost Information
16 System (“SCIS”) and Common Channel Signaling Cost Information System
17 (“CCSCIS”) and various other technical, financial and managerial courses since
18 joining AT&T.

19 **Q. WHAT IS YOUR PRIOR WORK EXPERIENCE?**

20 A. I began my career at AT&T in 1982 at the Bell System Sales Center as a
21 Telemarketing Supervisor where I sold AT&T products and network services. In
22 1984, I moved into AT&T's Network Organization, where I held positions as a
23 Switched Access Engineer, an Engineering Methods and Procedures Supervisor,

1 and on the Network Services Division Staff. In 1987, I transferred into
2 Government Affairs, where I have had interstate and intrastate regulatory
3 responsibilities, and where I have represented and testified for AT&T on
4 technical, costing, pricing, economic and policy issues. In 1993, I represented
5 AT&T on the Texas Commission task force that developed the original long run
6 incremental cost ("LRIC") rule for Texas, S.R. 23.91. In April of 1996 I was
7 named District Manager of Pricing and Cost. In that role, I testified and
8 supported witnesses in the original AT&T and SBC Section 251 and 252
9 arbitrations in Arkansas, Kansas, Missouri, Oklahoma and Texas following the
10 enactment of the Telecommunications Act of 1996 ("Telecom Act"). In January
11 of 1999 I assumed responsibilities for directing AT&T's Regulatory Affairs
12 operations in Kansas. In the summer of 2001, I became a member of AT&T's
13 National Cost Team. My primary purpose in this proceeding is to present expert
14 witness testimony on the total element long run incremental cost ("TELRIC") of
15 unbundled network elements ("UNEs") and, in particular, the appropriate labor
16 rates to use in calculating the TELRIC of the UNEs being investigated in this
17 proceeding.

18 **Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE STATE**
19 **COMMISSIONS REGARDING UNE COSTING ISSUES?**

20 A. Yes. I have testified for AT&T on UNE costing issues in Arkansas, California,
21 Kansas, Missouri, Oklahoma and Texas, in addition to filing testimony at the
22 Federal Communications Commission ("FCC") regarding UNE costing issues.

1 Attachment RPF-1 to my testimony lists other regulatory proceedings in which I
2 have participated.

3 **II. PURPOSE AND SUMMARY**

4 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

5 A. The purpose of my testimony is to examine the labor rates SBC asserts are
6 appropriate for use in its cost studies presented here for review and to discuss the
7 adjustments to those labor rates that are necessary to normalize them and bring
8 them into compliance with the requirements of the TELRIC methodology.

9 **Q. WOULD YOU PLEASE SUMMARIZE THE CONCLUSION THAT YOU**
10 **REACH IN YOUR TESTIMONY?**

11 A. My testimony concludes that SBC's proposed labor costs do not conform to the
12 requirements of the Telecom Act or the FCC's First Report and Order in CC
13 Docket 96-98 ("First Report and Order"), are not consistent with TELRIC
14 principles, and should be normalized toward competitive market-based labor
15 costs.

16 **III. LABOR RATES**

17 **A. INTRODUCTION**

18 **Q. WHAT IS TELRIC?**

19 A. TELRIC is a costing approach that bases the costs of UNEs on the costs of the
20 efficient inputs necessary to produce the UNEs -- costs of efficient activities and
21 costs of available state of the art equipment. Contrary to an embedded or
22 historical cost methodology, the TELRIC methodology is not a top down

1 approach that examines what the incumbent local exchange company ("ILEC")
2 actually spends and how it apportions all those expenditures to network elements.
3 Rather, TELRIC looks at utilization of UNEs not on an individual retail or
4 wholesale service basis, but on the basis of all usage of a particular UNE by all
5 services offered by the ILEC.

6 **Q. WHAT IS THE ORIGIN OF THE TELRIC METHODOLOGY AND**
7 **TELRIC-BASED RATES?**

8 A. Section 252(d)(1) of the Telecom Act requires that prices for UNEs:

9 (A) shall be--

10 (i) based on the cost (determined without reference to a
11 rate-of-return or other rate-based proceeding) of providing the interconnection or
12 network element (whichever is applicable), and

13 (ii) nondiscriminatory, and

14 (B) may include a reasonable profit.

15
16 The First Report and Order provided the FCC's interpretation of how prices for
17 interconnection and unbundled elements should be set under the Telecom Act.

18 The FCC coined the term TELRIC to describe the appropriate costing
19 methodology. TELRIC determines prices based on the long run cost an efficient
20 new entrant would face if it were to enter the market and serve the same volumes
21 served by the ILEC. The FCC defined the long run in the TELRIC methodology
22 as follows – "the 'long run' used shall be a period long enough that all costs are

1 treated as variable and avoidable.”¹ The FCC was emphatic that TELRIC was not
2 an embedded cost methodology.

3 Rather, we reiterate that the prices for the interconnection and network
4 elements critical to the development of a competitive local exchange
5 should be based on the pro-competition, forward-looking, economic costs
6 of those elements, which may be higher or lower than historical embedded
7 costs. Such pricing policies will best ensure the efficient investment
8 decisions and competitive entry contemplated by the 1996 Act, which
9 should minimize the regulatory burdens and economic impact of our
10 decisions on small entities.²

11 The United States Supreme Court has upheld the FCC’s definition of TELRIC
12 pricing.³ The incumbent LECs had challenged the FCC costing rules and argued
13 that cost must be tied to “actual” costs of the LECs, but the United States
14 Supreme Court definitively and finally rejected that argument:

15 The incumbent carriers' first attack charges the FCC with ignoring the
16 plain meaning of the word "cost" as it occurs in the provision of [§](#)
17 [252\(d\)\(1\)](#) that "the just and reasonable rate for network elements ... shall
18 be ... based on the cost (determined without reference to a rate-of- return
19 or other rate-based proceeding) of providing the ... network element"
20 The incumbents do not argue that in theory the statute precludes any
21 forward-looking methodology, but they do claim that the cost of providing
22 a competitor with a network element in the future must be calculated using
23 the incumbent's past investment in the element and the means of providing
24 it. They contend that "cost" in the statute refers to "historical" cost, which
25 they define as "what was in fact paid" for a capital asset, as distinct from
26 "value," or "the price that would be paid on the open market." Brief for
27 Petitioners in No. 00-511, p. 19. They say that the technical meaning of
28 "cost" is "past capital expenditure," *ibid.*, and they suggest an equation
29 between "historical" and "embedded" costs, *id.*, at 20, which the FCC
30 defines as "the costs that the incumbent LEC incurred in the past and that
31 are recorded in the incumbent LEC's books of accounts," [47 CFR §](#)
32 [51.505\(d\)\(1\) \(1997\)](#). The argument boils down to the proposition that "the
33 cost of providing the network element" can only mean, in plain language
34 and in this particular technical context, the past cost to an incumbent of

¹ *First Report and Order*, § 692.

² *Id.*, para. 705.

³ *Verizon Comm. Inc. v. FCC*, 122 S.Ct. 1646, 1665-66 (2002).

1 furnishing the specific network element actually, physically, to be
2 provided.

3
4 The incumbents have picked an uphill battle. At the most basic level of
5 common usage, "cost" has no such clear implication. A merchant who is
6 asked about "the cost of providing the goods" he sells may reasonably
7 quote their current wholesale market price, not the cost of the particular
8 items he happens to have on his shelves, which may have been bought at
9 higher or lower prices.⁴

10
11 We accordingly reach the conclusion adopted by the Court of Appeals,
12 that nothing in §252(d)(1) plainly requires reference to historical
13 investment when pegging rates to forward-looking "cost."⁵

14
15 And to the extent that the incumbents argue that there was at least an
16 expectation that some historically anchored cost-of-service method would
17 set wholesale lease rates, no such promise was ever made.⁶

18
19 As for an embedded cost methodology, the problem with a method that
20 relies in any part on historical cost, the cost the incumbents say they
21 actually incur in leasing network elements, is that it will pass on to lessees
22 the difference between most efficient cost and embedded cost. ... Any
23 such cost difference is an inefficiency, whether caused by poor
24 management resulting in higher operating costs or poor investment
25 strategies that have inflated capital and depreciation. If leased elements
26 were priced according to embedded costs, the incumbents could pass these
27 inefficiencies to competitors in need of their wholesale elements, and to
28 that extent defeat the competitive purpose of forcing efficient choices on
29 all carriers whether incumbents or entrants. The upshot would be higher
30 retail prices consumers would have to pay.⁷

31
32 Even when we have dealt with historical costs as a ratesetting basis, the
33 cases have never assumed a sense of 'cost' as generous as the incumbents
34 seem to claim. 'Cost' as used in calculating the rate base under the
35 traditional cost-of-service method did not stand for all past capital
36 expenditures, but at most for those that were prudent.⁸

37
38
39 **Q. HOW DOES TELRIC APPLY TO LABOR RATES?**

⁴ Id. at 1646, 1666.

⁵ Id. at 1667.

⁶ Id. at 1681.

⁷ Id. at 1673 (footnote omitted).

⁸ Id. at 1666 (footnote omitted).

1 A. TELRIC labor rates would represent the cost of labor in an open competitive
2 market. Such rates would not be based on embedded costs of the incumbent local
3 exchange carrier, but rather on costs that would prevail if there was effective
4 competition pervasive throughout the industry.

5 **Q. HAS SBC FILED TELRIC LABOR RATES IN THIS DOCKET?**

6 A. No. SBC's labor rates are based on embedded accounting data from 1999 (see
7 Attachment RPF-2, SBC's response to AT&T Data Request RF-30) and are not
8 consistent with TELRIC. Embedded data from one company in one year can be
9 full of aberrations that will not represent efficient costs in future years.
10 An example is overtime paid. The industry is changing and overtime paid in one
11 historical year may not represent the amount of overtime an efficient competitor
12 would pay in future years. The use of embedded salary dollars is also
13 problematic. SBC has reduced headcount significantly since 1999. It is
14 reasonable to assume that many of those that left the company were at the higher
15 end of the pay scale. Accordingly, the future demographics of the work force
16 could be far different from the demographics used by SBC as they existed in the
17 historical year it used in its cost studies.
18 Attachment RPF-3, SBC's response to AT&T Data Request RF-28a, demonstrates
19 that SBC's filed labor rates, based on 1999 data, do not reflect SBC's September
20 2002 company wide force reduction decision. SBC tells us its contract with its
21 labor unions allowed it to suspend or cancel commitments to the union if there
22 was a "significant change or extraordinary fluctuation in economic or business
23 conditions." While SBC recognized the changes in economic or business

1 conditions in its union relationships, it totally failed to recognize these same
2 changes in its purportedly TELRIC compliant labor rates. In contrast, the
3 normalized labor rates that AT&T proposes reflect current market conditions,
4 based on a wide universe of companies, so that changes in one company's
5 conditions would have minimal impact on AT&T's proposed rates.
6

7 As discussed above, TELRIC inputs must be economically efficient. In the long
8 run, which would represent an environment where vigorous competition exists in
9 SBC's currently monopolistic markets, SBC's labor expenses would become
10 aligned with (i.e., be brought down to) market levels. My testimony proposes the
11 use of those normalized labor rates in SBC's cost studies, consistent with
12 TELRIC methodology and principles.

13 **Q. COULD YOU PLEASE PROVIDE A GENERAL PERSPECTIVE**
14 **REGARDING THE LABOR SERVICES THAT ARE INCLUDED IN**
15 **SBC'S STUDIES?**

16 A. Yes. Economists look at labor as merely one of the three kinds of inputs that go
17 into production of services:

18 "...all production can be accounted for by the services of only three kinds
19 of inputs: all the gifts of nature such as land and raw materials to which
20 the economist gives the term *land*; all physical and mental efforts provided
21 by people, which are called *labor* services; and all machines and other
22 products that are not themselves components of the final goods. This third
23 type of input is called *capital* and is defined as manmade aids to further
24 production."⁹
25

⁹ Richard G Lipsey and Peter O. Steiner, *Economics*, (New York: Harper & Row, 3rd Edition, 1972), 172.

1 From a cost study perspective, the same disciplined approach to most efficient
2 costing should be applied to labor services as is applied to SBC's capital structure,
3 depreciation rates, expense factors, fill factors and other investments and
4 expenses.

5 **Q. HOW DO LABOR RATES IMPACT UNE RATES?**

6 A. Many of SBC's rates filed in this docket are dependent upon the underlying cost
7 of labor required to perform a function. Non-recurring costs ("NRC") are the
8 result of a labor rate multiplied by the time in hours required to perform a
9 function. Equipment investment includes the capitalized cost of installing the
10 equipment, including the labor costs involved. TELRIC studies should assume
11 that tasks are performed most efficiently (i.e., electronically where possible), but
12 some manual work may still be necessary. TELRIC requires that labor services,
13 like all other inputs, be included in cost studies only at long run efficient market
14 rates and not be constrained by embedded costs or contracts.

15 **Q. WHAT LABOR RATES HAS SBC ASSERTED ARE COMPLIANT WITH**
16 **TELRIC IN THE STUDIES?**

17 A. SBC has provided 203 unique labor cost developments in this docket. SBC's
18 labor costs ostensibly range from *****CONFIDENTIAL XXXXX END**
19 **CONFIDENTIAL***** per hour for a Console Operator in Missouri to
20 *****CONFIDENTIAL XXXXXX END CONFIDENTIAL***** per hour for an
21 Account Executive in Illinois. The mean and median of the 203 labor rates filed
22 by SBC are *****CONFIDENTIAL XXXXX** and **XXXXX END**

1 **CONFIDENTIAL***** per hour, respectively.¹⁰ SBC has filed 115 labor rates for
 2 management positions and 88 for non-management positions. SBC marks up its
 3 basic wages by factors in the range of *****CONFIDENTIAL** XXXXXXXXXX
 4 **END CONFIDENTIAL***** to arrive at its purported fully loaded labor rates.
 5 The derived mean and median factors SBC applies to basic wages to arrive at
 6 purported fully loaded labor rates are *****CONFIDENTIAL** XXXXXXXXXX,
 7 **END CONFIDENTIAL***** respectively. I have found significant aberrations in
 8 the labor rates filed by SBC, which must be normalized to bring the labor rates
 9 into compliance with TELRIC principles.

10 **Q. HOW DOES SBC DEVELOP ITS LOADED LABOR RATES?**

11 A. SBC begins by looking at its embedded books of account for 1999, and develops
 12 a base average hourly wage. It then applies a series of adjustments and factors,
 13 also based on its 1999 embedded costs, to arrive at a loaded labor rate. Table 1
 14 below captures, for an SBC Michigan Technical Specialist labor rate¹¹, the steps
 15 SBC goes through to arrive at its asserted loaded labor rates.

*****CONFIDENTIAL**

XXXXX
 XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX
 XXXXXXXXXXXXXXXXXXXX

Amount	

¹⁰ The mean is the average of a series of data points; the median is the data point with an equal number of values above and below.

¹¹ SBC has filed labor rates for employees in CA, IL, IN, MI, MO, OH, TX and WI in the instant case.

[illegible]

END CONFIDENTIAL***

1 **Q. DOES SBC MAKE AN ATTEMPT TO MODEL COMPETITIVE**
2 **MARKET-BASED LABOR COSTS IN ITS STUDIES?**

A. No. SBC gathers all the information to develop its labor rates from its internal financial systems. No attempt is made to determine if the rates or factors it uses in its cost studies are market-based and most efficient. If SBC's embedded average rate for a position was \$100 per hour and the market rate was \$20 per hour, SBC uses its embedded average rate of \$100.

8

9 B. BASIC SALARY AND WAGES

10 **Q. ARE SBC'S BASIC SALARIES AND WAGES TELRIC COMPLIANT?**

11 A. SBC has filed 203 distinct labor rates in this proceeding. Given the lack of
12 competition SBC has faced in its history, it would not surprise me if a few, or a
13 great many, of its basic salary or wage rates exceed rates that are being paid in

1 competitive markets. However, I have not been able to find a suitable benchmark
2 for each of the individual labor rates to make a proposed adjustment to them.
3 Therefore, for purposes of my analysis, I have accepted SBC's basic wages and
4 salaries.

5 While I do not criticize the base hourly wages paid by SBC to its employees, I do
6 criticize the factors and adjustments SBC applies to those base hourly wages. My
7 analysis accepts the wage and salary figures used by SBC and makes other
8 modifications to SBC's loaded labor rates, as I detail below.
9

10 **C. BREAK TIME ADJUSTMENT**

11 **Q. AFTER SBC DEVELOPS A WAGE RATE, WHAT IS THE FIRST**
12 **ADJUSTMENT SBC MAKES?**

13 A. The first adjustment SBC makes is a break time adjustment. Apparently SBC's
14 non-management employees are given two paid 15 minute breaks each day. SBC
15 would like the CLECs to foot the bill for these breaks. This equates to CLECs
16 paying SBC's non-management employees for 100% of an 8 hour day while
17 receiving only 93.75% of working hours during that 8 hour day.

18 **Q. ARE ILLINOIS EMPLOYERS REQUIRED TO GIVE EMPLOYEES A**
19 **HALF HOUR OF PAID BREAK TIME EACH DAY?**

20 A. I am not a lawyer, but it is my understanding that there are no Illinois, or federal,
21 laws or regulations that require giving employees such breaks. If an electrician or
22 a plumber came to my house and worked for 7.5 hours and billed me for 8 hours I
23 would not be too happy – I would find a different electrician.

1 **Q. DO YOUR PROPOSED ADJUSTED LABOR RATES ADDRESS NON-**
2 **PRODUCTIVE TIME?**

3 A. Yes. I began this section of my testimony stating that labor services are just one
4 of the three major categories of inputs to the production process. Labor assets are
5 similar to capital assets in that it is neither possible nor efficient to use them at
6 100% of their capacity all of the time. I therefore propose an adjustment to
7 incorporate a “95% productive time factor” for the labor assets in the studies. In
8 other words, I assume that 5% of the time the workers will essentially be idle.
9 While SBC asserts break time for its non-management employees only, I
10 conservatively apply the 95% productive time factor to all wage rates, including
11 wage rates for management employees. By including such a factor in the
12 development of each SBC wage rate, the Commission should have no qualms
13 about reducing SBC’s asserted task times to the actual efficient times that would
14 result from time and motion or other studies, and eliminating the slack that SBC
15 has built into its asserted task times.

16 **Q. ISN'T THE DIFFERENCE BETWEEN YOUR PROPOSED 95%**
17 **PRODUCTIVE TIME AND SBC'S 93.75% PRODUCTIVE TIME**
18 **MINIMAL?**

19 A. From a results standpoint, for non-management workers, the difference is
20 minimal. However, from a TELRIC principles standpoint the two approaches are
21 at polar extremes. SBC's approach merely reflects embedded contracts – contrary
22 to TELRIC principles. AT&T's approach looks at how an efficient company
23 would operate on a going forward basis. No reasonable company would expect

1 its workers to engage in productive activities 100% of the day, every working day
2 of the year; this principle applies to both management and non-management
3 workers.

4
5 **D. SBC'S BENEFIT LOADINGS**

6 **Q. WHAT IS THE NEXT ADJUSTMENT SBC MAKES IN ITS STUDIES?**

7 A. SBC increases the labor rate by a series of factors to take into account the cost of
8 benefits. These include:

- 9 • Paid absence
- 10 • Premium Overtime and Special Payments
- 11 • Wage Increases
- 12 • Social Security, Medicare and Pensions
- 13 • Life Insurance, Savings Plans & Medical Plans
- 14 • Other Expenses

15 Taken together, these benefit loadings range from ***CONFIDENTIAL XXXX
16 XXX END CONFIDENTIAL*** of the basic wages contained in SBC's loaded
17 labor rates. SBC's mean and median loadings for these elements are
18 ***CONFIDENTIAL XXXXXXXX, END CONFIDENTIAL*** respectively.

19 **Q. IN GENERAL, HAVE YOU FOUND ANY PUBLICLY AVAILABLE**
20 **DATA THAT COULD BE USED TO BENCHMARK SBC'S BENEFIT**
21 **LOADINGS?**

22 A. Yes. The United States Department of Labor's Bureau of Labor Statistics
23 ("BLS") publishes information on wages and benefits. The BLS data is factual,

1 unbiased and impartial. On June 19, 2002 the BLS released its “Employer Costs
2 for Employee Compensation” (“ECEC”), which provides information on relative
3 percentages of wages versus benefits that are provided by employers. The ECEC
4 is attached as Attachment RPF-4. The BLS survey took place in March 2002 and
5 covered “29,850 occupations within approximately 7,200 sample establishments
6 in private industry.”¹² Table 16 on page 21 of the report provides information on
7 the relative weighting of wages and salaries versus benefits for communications
8 public utility companies (standard industrial classification (“SIC”) code 48).¹³
9 BLS shows that 67.1% of overall employee compensation, from this broad sample
10 of companies, comes from salaries and wages and 32.9% comes from benefits.
11 Another way of stating this is that the BLS normal market benefits are 49% of
12 basic wages (.329/.671). SBC benefit loadings are generally well above normal
13 market loadings.

14 **Q. YOU HAVE CRITICIZED SBC FOR BASING ITS LABOR RATES ON**
15 **ONE YEAR OF DATA. HAVE YOU EXAMINED BLS LOADINGS FOR**
16 **MORE THAN JUST ONE YEAR?**

17 A. Yes. As stated above, TELRIC labor rates should not be based on data from just
18 one company or by using just one point in time. The BLS also publishes
19 historical data on the percent of total compensation that is attributable to benefits
20 for SIC 48. On June 9, 2002, the BLS published its “Employer Costs for
21 Employee Compensation Historical Listing (Annual), 1986-2001” (Attachment

¹² See BLS at p. 22.

¹³ Subcategories of SIC code 48 are: SIC 481 Telephone Communications, SIC 482 Telegraph and Other Message Communications, SIC 483 Radio and Television Broadcasting Stations, SIC 484 Cable and Other Pay Television Stations and SIC 489 Communications Services Not Elsewhere Classified. All of the RBOCs fall under SIC 48.

RPF-5.) Table 22 on page 206 provides the historical data for SIC 48. The historical annual benefit percentages of total compensation and basic wages are as follows:

Table 2
Historical Benefits % of Compensation and Wages

Year	Benefits % of Overall Compensation	Benefits % of Wages
1995	31.9%	47%
1996	32.1%	47%
1997	29%	41%
1998	29.9%	43%
1999	30.5%	44%
2000	30.6%	44%
2001	32.3%	48%

Thus, the 49% quarterly data point I use in my analysis is conservative – it results in a higher loaded labor rate than would be derived from using any of the prior years' annual data points. The average benefit loading used by SBC of ***BEGIN PROPRIETARYXXX END PROPRIETARY*** is nearly ***CONFIDENTIAL XXXX END CONFIDENTIAL*** the normalized market loading of 49%.

Q. HOW DOES THE LOADING OF 49% OF BASIC WAGES FOR SIC 48 COMPARE TO NATIONAL AVERAGES, OTHER INDUSTRIES AND OTHER CROSS SECTIONS?

A. According to the most recent ECEC report from the BLS released March 18, 2003 (Attachment RPF-6), private industry employers nationally paid benefits equal to 37.7% of basic wages on average. Thus the 49% figure that I use to normalize SBC's benefit loadings is well above the national average for all private industry

and is, therefore, conservative. The BLS provides many additional views of benefits relative to basic wages; the table below shows how the percentages generally range. The average benefit percent of wages across the categories is 40%; the median value is 39%. The range of values is from a low of 31% to a high of 52%. The 49% I use to normalize the SBC loadings falls close to the highest percentage in the representative sample, again demonstrating that the adjustments I propose are conservative. There are no categories that approach SBC's average benefit loading of *****CONFIDENTIAL XXX END**
CONFIDENTIAL***.

Table 3
ECEC Benefits % of Wages

	% Wages	% Benefits	Benefits % of Wages
All Private Industry Workers	72.6	27.4	38%
Goods Producing Industries	68.5	31.6	46%
Service Producing Industries	74	26	35%
Manufacturing Industries	67.7	32.2	48%
Nonmanufacturing Industries	73.6	26.4	36%
White Collar Workers	73.6	26.4	36%
Blue Collar Workers	69.1	30.9	45%
Service Workers	76.6	23.5	31%
Northeast Region	71.6	28.5	40%
South Region	73.5	26.5	36%
Midwest Region	71.8	28.2	39%
West Region	73.2	26.8	37%
Union	65.6	34.4	52%
Nonunion	73.8	26.2	36%
1-99 Workers	74.8	25.2	34%
100 Workers or more	70.7	29.3	41%
100 - 499 Workers	71.7	28.3	39%
500 Workers or more	69.8	30.2	43%
Full time Workers	71.4	28.6	40%

Q. WHAT MODIFICATIONS DO YOU PROPOSE TO SBC'S BENEFIT LOADINGS?

A. While BLS breaks the benefits category into paid leave, supplemental pay, insurance, retirement and savings, legally required benefits and other, I apply the BLS overall benefit factor to SBC's hourly rates to arrive at a labor rate including benefits instead of modifying each specific subcategory of benefits proposed by SBC. In other words, I take SBC's hourly wage rate and divide by the .671 overall benefit factor from the BLS to arrive at a labor rate including benefits. Below, I will discuss each subcategory of benefits to demonstrate that SBC's specific loadings are overstated, but do not propose that the Commission adopt each individual adjustment. Adopting each individual adjustment would yield essentially the same result. The following table shows the benefit cost relationships by category for SIC 48 companies.

Table 4
BLS Subcategory Benefit % of Wages and Total Compensation

	Total Compensation	Wages and Salaries	Benefits Total	Paid Leave	Supplemental Pay	Insurance	Retirement and Savings	Legally Mandated Benefits	Other Benefits
% of Total Compensation	100.0%	67.1%	32.9%	9.2%	4.9%	6.8%	4.9%	6.9%	0.3%
% of Wages and Salaries	149%	100%	49.03%	13.71%	7.30%	10.13%	7.30%	10.28%	0.45%

Q. HOW DOES SBC'S ADJUSTMENT FOR PAID ABSENCE COMPARE WITH THE BLS BENCHMARK DATA?

A. BLS defines paid absence as vacations, holidays, sick leave and other leave.¹⁴
BLS shows paid leave costs equivalent to 13.71% of a communication worker's

¹⁴ The BLS benefit category definitions can be found in "Employer Costs for Employee Compensation Historical Listing (Annual), 1986-2001", June 19, 2002, page 2. (Attachment RPF-5)

1 basic wages and salaries. SBC's embedded data for paid absence varies from

2 ***CONFIDENTIAL XX END CONFIDENTIAL*** to

3 ***CONFIDENTIAL XXX END CONFIDENTIAL*** with an average value

4 of ***CONFIDENTIAL XXX END CONFIDENTIAL***.

5 **Q. HOW DOES SBC'S ADJUSTMENT FOR PREMIUM OVERTIME AND**
6 **SPECIAL PAYMENTS COMPARE WITH THE BLS BENCHMARK**
7 **DATA?**

8 A. SBC increases the labor rate by a special payments factor that purportedly
9 represents premium overtime and special payments (team awards, overtime pay,
10 etc.) paid throughout the year. The BLS Table 16 contains an industry benchmark
11 that SBC would meet or beat if it were efficient and operating in a competitive
12 environment. The BLS calls this category supplemental pay -- premium pay for
13 work in addition to the regular work schedule (such as overtime, weekends, and
14 holidays), shift differentials, and non-production bonuses (such as referral
15 bonuses and lump-sum payments provided in lieu of wage increases). BLS shows
16 supplemental pay costs equivalent to 7.3% of a communication worker's basic
17 wages and salaries. In contrast, SBC's embedded data for special payments
18 varies from ***CONFIDENTIAL XX END CONFIDENTIAL*** to
19 ***CONFIDENTIAL XXX END CONFIDENTIAL*** with an average value
20 of ***CONFIDENTIAL XXX END CONFIDENTIAL***.

21 **Q. WHAT IS THE NEXT ADJUSTMENT SBC MAKES IN ITS STUDIES?**

22 A. SBC applies a factor for wage increases.

1 **Q. IS IT APPROPRIATE FOR SBC TO APPLY THIS FORWARD LOOKING**
2 **FACTOR TO EMPLOYEE WAGES?**

3 A. No. If SBC had perfect foresight and could also apply a forward-looking
4 efficiency factor, then perhaps it would be acceptable to apply a forward-looking
5 wage factor. SBC's workers should become more efficient in doing their jobs as
6 time goes by through the introduction of new technology and through the benefit
7 of additional experience. Since SBC's studies fail to include an increase in
8 efficiency, neither should its studies include an increase in wages or a forward
9 looking adjustment for inflation.

10 **Q. WHAT DATA SUPPORT YOUR POSITION THAT WAGE INCREASES**
11 **AND, SIMILARLY, INFLATION INCREASES SHOULD NOT BE**
12 **INCLUDED IN SBC'S STUDIES?**

13 A. The BLS provides data on worker productivity per hour. It also provides the
14 Consumer Price Index ("CPI") data. I compared worker productivity increases
15 versus the CPI for the years 1996 – 2000, the most recent data years available, as
16 shown in Table 5 below. I concluded that worker productivity increases exceed
17 inflation price increases by 3.8% per year on average. This data is specific to SIC
18 code 481, which represents Telephone Communications companies. Attachment
19 RPF-7 is a list of 852 companies registered with the SEC as SIC code 481
20 companies; SBC is one of the companies on the list.¹⁵

Table 5

¹⁵ BLS reports are developed at various levels of aggregation. For example, some data is kept at the SIC 48 Private Industry Communications level (more generic) and other data is kept at SIC 481 Telephone Communications Companies (more specific). Copyright © 2003 Fran Finnegan & Company Inc. All Rights Reserved. www.secinfo.com - Tue, 21 Jan 2003 20:55:04 GMT.

Comparison of Inflation and Productivity for Telephone Communications Companies

SIC Code 481	1995	1996	1997	1998	1999	2000	AVG
Productivity Index ¹⁶	148.1	159.5	160.9	170.1	186.3	201.3	
Productivity % Change Per Hour		7.7%	0.9%	5.7%	9.5%	8.1%	6.4%
CPI % Change From Prev Dec ¹⁷		3.3%	1.7%	1.6%	2.7%	3.4%	2.5%
Compare CPI to Productivity		-4.4%	0.8%	-4.1%	-6.8%	-4.7%	-3.8%

1 This data demonstrates that blind adjustments for inflation and wage increases
2 would misrepresent what is happening in the real world. If productivity gains
3 exceed inflation, SBC's activity costs per labor hour would actually decrease each
4 year, even if the nominal wages increase. While the absolute level of labor rates
5 may have normally increased in the past, the actual cost of labor has decreased
6 due to the high productivity gains in the industry. If adjustments to SBC's studies
7 were to be made, forward looking productivity and inflation adjusted labor rates
8 should be captured in a TELRIC study, and not just the inflation adjusted labor
9 rates. Based on this data, I strongly urge the Commission to reject the wage
10 increase and inflation increase factors in SBC's labor rate studies. Because I am
11 not suggesting that the Commission include a downward adjustment to labor rates
12 to reflect the fact that the productivity improvement has exceeded the inflation
13 rate, the normalized labor rates I am proposing in this proceeding are very
14 reasonable and conservatively high.

15 **Q. HOW DOES SBC'S ADJUSTMENT FOR SOCIAL SECURITY,**
16 **MEDICARE AND PENSIONS COMPARE WITH THE BLS**
17 **BENCHMARK DATA?**

¹⁶ Industry Labor Productivity Indexes, 1987 Forward, All Published 3-Digit Industries
Indexes of Output per Hour, All Published 3-Digit Industries, (November 13, 2002)
<ftp://ftp.bls.gov/pub/special.requests/opt/dipts/oaeh3din.txt>.

¹⁷ Table Containing History of CPI-U U.S. All Items Indexes and Annual Percent Changes From 1913 to
Present (November 13, 2002) <ftp://ftp.bls.gov/pub/special.requests/cpi/cpiat.txt>.

1 A. The BLS table contains two categories that, combined, would be an appropriate
2 analog:

- 3 1. Legally Required Benefits -- social security, Medicare, Federal and State
4 unemployment insurance, and workers' compensation; and
5 2. Retirement and Savings -- defined benefit and defined contribution plans.
6

7 BLS shows these categories cost a communications employer 7.3% and 10.28%
8 of wages, respectively, for a total of 17.58% of wages. SBC's corresponding
9 embedded data factors range from a low of ***CONFIDENTIAL XXX END
10 CONFIDENTIAL*** to a high of ***CONFIDENTIAL XXX END
11 CONFIDENTIAL*** with an average cost of ***CONFIDENTIAL XX END
12 CONFIDENTIAL*** of basic wages.

13 **Q. HOW DOES SBC'S ADJUSTMENT FOR GROUP LIFE INSURANCE,**
14 **SAVINGS PLANS AND MEDICAL PLANS COMPARE WITH THE BLS**
15 **BENCHMARK DATA?**

16 The BLS table includes a category for insurance benefits -- life, health, short-term
17 disability, and long-term disability. BLS shows this category of costs to be
18 10.13% of basic wages. SBC's embedded factors range from a low of
19 ***CONFIDENTIAL XX END CONFIDENTIAL*** to a high of
20 ***CONFIDENTIAL XX END CONFIDENTIAL*** with an average cost of
21 ***CONFIDENTIAL XX END CONFIDENTIAL*** of basic wages.
22

1 **Q. WHAT IS THE NEXT ADJUSTMENT MADE BY SBC IN ITS STUDIES**
2 **RELATED TO BENEFIT LOADINGS?**

3 A. SBC applies an adjustment for other expenses. SBC alleges that this adjustment
4 “captures other direct employee-related costs, such as costs for conferences and
5 travel, home relocation, tuition, training and others.” A close examination of the
6 embedded accounting data shows that SBC includes much more than these types
7 of costs in this adjustment. It is not just the type of expenditures, but also the
8 amount of the expenditures compared to what other companies are spending that
9 requires a normalization to bring SBC’s labor rates into compliance with the
10 TELRIC methodology. SBC does not provide factors for this particular category,
11 but I derived factors by dividing the dollar amount given by SBC by the average
12 hourly wage provided by SBC.

13 **Q. WHAT QUESTIONABLE EMBEDDED COSTS DOES SBC INCLUDE IN**
14 **THIS ADJUSTMENT?**

15 A. There are many of them, including:

Table 6
Non-TELRIC Costs in Other Expenses

*****CONFIDENTIAL**

File	Item Description	Amount

END CONFIDENTIAL***

1 These are just a sample of the entries that SBC asserts belong in a TELRIC labor
2 rate study as “other” expenses. One example, “Other” – the first item listed in
3 Table 6 - could represent virtually anything. Without a solid explanation why
4 these expenses should appropriately be included in a TELRIC study, the
5 *****CONFIDENTIAL XXXXXXXX END CONFIDENTIAL***** entry should be
6 ignored. The same is true for “Other Expense – Subject to Gross Up Allowance”
7 and “Other Business Costs”. Severance payments are non-recurring extraordinary
8 items and should not be routinely added to forward looking labor rates.
9 Moreover, if SBC chooses to pay its employees for personal use of motor vehicles
10 above the IRS limits, these costs should not be loaded onto the UNE rates that
11 CLECs pay. These miscellaneous costs are unsupported and are not TELRIC
12 compliant. Furthermore, SBC has failed to demonstrate that the amount of these
13 purported expenses is most efficient, as required by the TELRIC methodology.

14 **Q. HAVE YOU FOUND ANY PUBLICLY AVAILABLE DATA THAT**
15 **COULD BE USED TO BENCHMARK THIS “OTHER EXPENSES”**
16 **CATEGORY?**

17 A. Yes. The BLS table contains a column for other benefits, which includes
18 severance pay and supplemental employment benefits. These other benefits
19 amount to .45% of wages. This compares to the factors I have derived from
20 SBC’s embedded data which range up to *****CONFIDENTIAL XXX END**
21 **CONFIDENTIAL***** and average *****CONFIDENTIAL XXX END**
22 **CONFIDENTIAL***** of the base wage.

1 **E. MANAGEMENT HOURS**

2 **Q. DO YOU HAVE ANY COMMENTS SPECIFIC TO THE MANAGEMENT**
3 **LABOR RATE HOURS ASSERTED BY SBC?**

4 A. Yes. Of the 203 wage levels that SBC filed, 115 are management positions. It is
5 my understanding that SBC's cost study labor rates for these management
6 positions are based on 40 hour work weeks. This understanding has been
7 corroborated by SBC's response to AT&T Data Request RF-18 (appended as
8 Attachment RPF-8 to this testimony.) It is my experience that managers normally
9 work more than 40 hours per week, and receive no overtime payment for their
10 extra hours. SBC's studies do not recognize extra hours worked by managers.
11 This means that the SBC managers' effective wages per hour, and SBC's
12 management labor costs per hour, are less than what SBC portrays them to be in
13 its studies.

14 **Q. WHAT IS THE IMPACT OF SBC'S 40 HOUR PER WEEK ASSUMPTION**
15 **FOR MANAGERS?**

16 A. When managers work more than 40 hours per week, the per hour cost to SBC for
17 the labor services is less than what it would be under a 40 hour work week
18 assumption. The extra hours they work essentially are free for SBC, driving
19 down the hourly cost to SBC for labor services. UNE rates must not only meet
20 TELRIC standards, they also must be nondiscriminatory. It would be
21 discriminatory and contrary to section 252(d)(1)(a)(ii) of the Telecom Act for
22 SBC to charge CLECs a higher rate for labor services than what SBC effectively
23 charges itself.

1 **Q. DO YOU HAVE ANY DATA TO SUPPORT THE ASSERTION THAT**
2 **MANAGERS WORK MORE THAN 40 HOURS PER WEEK?**

3 A. Yes. I was able to obtain from the BLS a table, Table 30B,¹⁸ based on the BLS
4 Current Population Survey (“CPS”), which shows average hours for people that
5 customarily work full time. The CPS is a monthly sample survey of about 50,000
6 households. The table is attached to my testimony as Attachment RPF-9. The
7 data (page 2 line 2) shows that in 2001, for Managerial and Professional Specialty
8 occupations, management employees worked an average of 44.2 hours per week.
9 SBC’s managerial labor wages and salaries per hour are based on a 40 hour work
10 week and are thus overstated by 10.5%. It is very possible that SBC managers
11 work even more than 44.2 hours per week in the current environment.

12 **Q. DO YOU HAVE MORE SPECIFIC INFORMATION ON WHAT JOBS**
13 **ARE INCLUDED IN THE MANAGERIAL AND PROFESSIONAL**
14 **SPECIALTY CATEGORY DISCUSSED ABOVE?**

15 A. Yes. Attachment RPF-10 to my testimony gives a more detailed breakdown of
16 the jobs included in this category. A few of the more specific job titles are:
17 financial managers, personnel and labor relations managers, purchasing managers,
18 accountants and auditors, other financial officers, engineers and computer systems
19 analysts and scientists.¹⁹

¹⁸ Bureau of Labor Statistics, Table 30B (2001). Persons at work by actual hours of work at all jobs in the reference week, major occupation, and sex. Unpublished 2001 annual average data from the Current Population Survey.

¹⁹ There are other job titles on the list that may not normally be found at SBC. Regardless, this data is representative, unbiased and quantifies the number of extra hours worked by management employees in general.

1 **Q. WHAT ADJUSTMENT IS NECESSARY TO BRING MANAGEMENT**
2 **LABOR RATES INTO COMPLIANCE WITH TELRIC PRINCIPLES?**

3 A. In column AC of my "Master" labor rate analysis spreadsheet (see my
4 workpapers) I apply a factor of .9050 to the normalized hourly rate, including
5 loadings, for management labor rates. For non-management labor rates, I apply a
6 factor of 1 and do not adjust them to account for a longer work week. The .9050
7 factor equals 40/44.2 and effects a 10.5% reduction in the hourly loaded labor rate
8 for managers.

9

10 **F. SUPPORT ASSETS**

11 **Q. WHAT IS THE NEXT ADJUSTMENT MADE BY SBC IN ITS STUDIES?**

12 A. SBC applies a Support Assets factor adjustment.

13 **Q. WHAT IS THE SUPPORT ASSETS FACTOR?**

14 A. The support assets factor is designed to capture the costs of computers, furniture,
15 tools and other assets consumed in the course of providing labor services. The
16 factor includes both the capital cost and the expenses associated with the support
17 assets.

18 **Q. HAVE YOU FOUND A PUBLICLY AVAILABLE ANALOG FOR THIS**
19 **FACTOR?**

20 A. No. I am not aware of any such analog. However, AT&T/Joint CLEC witnesses
21 Mr. Starkey and Mr. Fischer have examined SBC's development of the support
22 assets factors and have provided me revised factors to use in restating SBC's
23 labor rates. SBC's support assets factors and AT&T's adjusted factors are shown

1 in the tables below. Since SBC has filed labor rates with distinct support asset
2 factors for the Ameritech region, the Southwestern Bell Telephone, or SWBT,
3 region and California, I am presenting three tables with three corresponding sets
4 of revised support asset factors.

Table 7
Support Asset Adjustment - Ameritech States
*****CONFIDENTIAL**

Category of Labor	SBC Support Asset Factor	AT&T Adjusted Support Asset Factor

Table 8
Support Asset Adjustment MO & TX Rates

Category of Labor	SBC Support Asset Factor	AT&T Adjusted Support Asset Factor

Table 9
Support Asset Adjustment CA Rates

Category of Labor	SBC Support Asset Factor	AT&T Adjusted Support Asset Factor

END CONFIDENTIAL***

1 **G. CLERICAL SUPPORT**

2 **Q. WHAT ARE THE NEXT ADJUSTMENTS SBC MAKES IN ITS STUDIES?**

3 A. The next adjustment SBC makes is for Clerical Support. SBC represents these
4 costs as costs of clerical employees that support others in the group.²⁰ SBC's
5 embedded data asserts clerical support loadings ranging up to
6 ***CONFIDENTIAL XXXX END CONFIDENTIAL*** per hour, 64.1% of
7 the base wage, and an average loading of ***CONFIDENTIAL XXXX END
8 CONFIDENTIAL*** per hour, 9.2% of base wages.

9 **Q. HAVE YOU DISCOVERED ANY PROBLEMS WITH THIS**
10 **PARTICULAR SBC ADJUSTMENT?**

11 A. Yes. SBC adds on to clerical salaries and wages an average
12 ***CONFIDENTIAL XX END CONFIDENTIAL*** for special payments,
13 ***CONFIDENTIAL XXX END CONFIDENTIAL*** for paid absence, a
14 benefit factor of ***CONFIDENTIAL XXX END CONFIDENTIAL***, a

²⁰ The amount of clerical support varies based on, among other things, the number of workers supported per clerk. For example, if a clerk costs \$40 per hour and supports 4 workers, the loading per hour for each worker will be \$10. If the same clerk supports 8 workers, the loading per hour will be \$5.

1 *****CONFIDENTIAL XXX END CONFIDENTIAL***** wage increase factor,
2 and a *****CONFIDENTIAL XXXX END CONFIDENTIAL***** social security
3 factor, for a total factor increase of *****CONFIDENTIAL XXXX END**
4 **CONFIDENTIAL*****. The BLS equivalent factors are approximately 7.3% for
5 special payments, 13.7% for paid absence, 10.13% for benefits, and 17.58% for
6 social security, relief and pensions. AT&T does not include a factor for salary
7 increases for the reasons discussed above. Thus, the BLS/AT&T equivalent total
8 factor is 48.71%. In addition, SBC applies a “support assets other” factor that
9 averages *****CONFIDENTIAL XXX END CONFIDENTIAL*****. Mr. Starkey
10 and Mr. Fisher have provided me with the adjusted factors I discussed above, the
11 average of which is *****CONFIDENTIAL XXX END CONFIDENTIAL*****. I
12 have modified SBC’s asserted clerical support expenses by multiplying SBC’s
13 reported salaries by the .4871, and adding *****CONFIDENTIAL XXXX END**
14 **CONFIDENTIAL** multiplied by the sum of SBC’s asserted salaries, paid
15 absence and special payments. This results in a Clerical Support adjustment
16 averaging *****CONFIDENTIAL XXXX END CONFIDENTIAL***** compared
17 to SBC’s average *****CONFIDENTIAL XXXX END CONFIDENTIAL*****.
18 The table below shows the difference between AT&T’s calculation of clerical
19 support and SBC’s asserted clerical support for an Illinois Outside Plant
20 Technician. As one can see from Table 10, the AT&T normalization actually
21 results in an increase in SBC's clerical support adjustment for this particular job
22 function.

Table 10
Illustration of AT&T Clerical Support Adjustment

*****CONFIDENTIAL**

	SBC	AT&T	Comment

END CONFIDENTIAL***

H. SUPERVISORY SUPPORT

Q. WHAT ARE THE NEXT ADJUSTMENTS MADE BY SBC IN ITS STUDIES?

A. The next adjustment SBC makes is for Supervisory Support. SBC describes this as accounting for the cost of employees that supervise others in the group. SBC adjusts the rates upward by as much as *****CONFIDENTIAL XXXX END CONFIDENTIAL***** per hour, or an average increase of *****CONFIDENTIAL XXXX END CONFIDENTIAL***** per hour.

Q. HAVE YOU DISCOVERED ANY PROBLEMS WITH THIS SBC ADJUSTMENT?

A. Yes. SBC adjusts its basic wages upward to capture salaries and wages, special payments, paid absence, benefits, wage increase and social security for supervisory support. I accept the supervisory salary dollars asserted by SBC and apply BLS factors of 7.3% for special payments, 13.71% for paid absence, 10.13% for benefits, and 17.58% for social security, relief and pensions to those

18 ***CONFIDENTIAL

[illegible]

	SBC	AT&T	Comment

END CONFIDENTIAL***

1 **Q. ARE THERE ANY OTHER PROBLEMS YOU HAVE FOUND WITH**
2 **SBC'S SUPERVISORY SUPPORT COSTS?**

3 A. Yes. For 37 of its labor rates, SBC shows either \$0 or negative dollars for the
4 salary dollars in the supervisory support cost category, but goes on to show
5 positive dollars in the loadings and a resultant add-on to the labor rate. It does not
6 make sense to have supervisor support loadings when there are no supervisory
7 support wage or salary dollars.

8 **Q. CAN YOU PROVIDE AN EXAMPLE OF THIS ABERRATION?**

9 A. An example is an 02XX01 Illinois Manager. SBC shows *****CONFIDENTIAL**
10 **XXXX END CONFIDENTIAL***** management hours for this labor rate, but
11 zero salary dollars for management employees. SBC proposes
12 *****CONFIDENTIAL XXXX END CONFIDENTIAL***** in paid absence
13 loadings, *****CONFIDENTIAL XXXX END CONFIDENTIAL***** in special
14 payments, *****CONFIDENTIAL XXXX END CONFIDENTIAL***** in raise
15 dollars, and *****CONFIDENTIAL XXXX END CONFIDENTIAL***** in
16 support assets, for a total of *****CONFIDENTIAL XXXX END**
17 **CONFIDENTIAL***** per hour in supervisory support costs.

18 **Q. WHAT DO YOU PROPOSE THE COMMISSION DO IN THESE CASES?**

1 A. In these 37 cases where SBC reports no supervisory support salary dollars, I urge
2 the Commission to reject all supervisory support expense loadings. The
3 normalized labor rates I am proposing adhere to this principle.
4

5 **I. SUPPORT AND SUPERVISION -- OTHER**

6 **Q. WHAT IS THE NEXT ADJUSTMENT MADE BY SBC IN ITS STUDIES?**

7 A. The next SBC adjustment is for Support and Supervision – Other. This
8 adjustment is supposed to represent the other expenses associated with employees
9 who provide clerical support and supervision. SBC asserts an additional
10 *****CONFIDENTIAL XXXXXX END CONFIDENTIAL***** per hour for this
11 adjustment. I have no comment on these adjustments and have made no
12 modification to them.
13

14 **J. INFLATION**

15 **Q. IS IT APPROPRIATE FOR SBC TO APPLY INFLATION FACTORS TO**
16 **ITS LABOR RATES?**

17 A. No. As I discussed above, inflation factors are inappropriate because SBC does
18 not include the corresponding – and nearly always offsetting -- productivity
19 factors.

20 **Q. IS THERE ANY OTHER SUPPORT FOR REMOVING INFLATION?**

1 A. Yes. Other state commissions (e.g., Texas, Missouri and Kansas) have removed
2 inflation adjustments in the SBC studies due to the absence of offsetting
3 productivity adjustments.²¹
4

5 The Missouri Commission was very lucid on this point in its recent order:

6 SBC does include overt inflation factors in its cost studies so that inflation
7 will not be fixed at the time of the study. As a result, SBC's cost studies
8 will tend to overstate actual costs.

9 This problem could be solved by requiring SBC to incorporate overt
10 prospective productivity adjustments into its cost studies but no party has
11 proposed a formula that would permit the easy development of such
12 adjustments. However, the expert witnesses for both Staff and the Joint
13 Sponsors indicate that productivity factors would roughly balance out the
14 inflation factors and that if productivity factors are not used, then inflation
15 factors should also be excluded. For that reason, the Commission will
16 order SBC to exclude overt inflation factors from its cost studies.²²
17
18

19 **K. SUMMARY**

20 **Q. IN SUMMARY, WHAT ADJUSTMENTS ARE YOU RECOMMENDING**
21 **THE COMMISSION MAKE TO SBC'S LABOR RATES IN ITS COST**
22 **STUDIES?**

23 A. My proposal is for the Commission to start with the wage and salary figure given
24 by SBC. The Commission should then divide by the .67 overall benefit factor

²¹ Kansas Docket No. 97-SCCC-149-GIT, Order Setting Inputs For Cost Studies, page A-36 (Nov. 17, 1998) ("If an inflation factor is adopted, a productivity factor should also be adopted. SWBT's cost studies do not include an explicit productivity factor. Staff states if a separate adjustment for productivity were to be made, that adjustment could more than offset the inflation adjustment. Missouri, Arkansas, Texas and Oklahoma eliminated the inflation factor to offset the lack of a productivity factor. The United States District Court, Western District of Texas recently affirmed the Texas Public Utilities Commission's decision. SWBT v. AT&T, No. A97-CA - 132SS (W.D. Tex. 1998) Removing the inflation adjustment from SWBT's TELRIC cost studies represents a reasonable and conservative way of addressing these issues.")

²² Missouri Case No. TO-2002-438, Report and Order, Issue 64 (August 6, 2002), available at <http://www.psc.state.mo.us/orders/08061438.htm>. The Missouri Commission had reached this same conclusion in Missouri Case No. TO-97-40, Final Arbitration Order, Adopting Staff's Recommendation attached as Appendix C, pg. 119 (July 31, 1997).

1 from the BLS to arrive at a labor rate, including benefits. The 95% adjustment
2 factor should then be applied to the labor rate, including benefits, to account for
3 5% non-productive time. The management hours adjustment I propose should
4 then be applied to recognize that managers normally work more than 40 hours per
5 week. The support asset factors developed by Mr. Starkey and Mr. Fisher should
6 then be applied, instead of the support asset factors developed by SBC. The
7 Commission should then apply the adjusted clerical and supervisory support
8 amounts described above, as well as SBC's Support and Supervision – Other
9 adjustment. Finally, the Commission should eliminate any wage increase and
10 inflation factors. The workpapers provided to SBC demonstrate all the steps and
11 calculations I have used to derive normalized TELRIC labor rates for SBC.

12 **Q. HOW DO YOUR NORMALIZED LABOR RATES COMPARE WITH**
13 **SBC'S PROPOSED LABOR RATES?**

14 A. Normalizing SBC's fully loaded labor rates to bring them into compliance with
15 TELRIC results in a mean reduction of 20%, a median reduction of 19% and a
16 range of reductions from 3% to 32%. Again, I have made no changes to the stated
17 wages and salaries filed by SBC. The adjustments I have made are to the loading
18 costs added on by SBC to its basic wages and salaries.

19 **Q. WHAT ARE YOUR FINAL PROPOSED TELRIC LABOR RATES?**

20 A. Table 12 below displays the 203 fully loaded labor rates proposed by AT&T for
21 use in the studies and compares them with the SBC filed non-TELRIC labor rates.

Normalized TELRIC Results by Labor Rate Category

*****CONFIDENTIAL**

[illegible]

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[illegible]

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[illegible]

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[illegible]

2

TABLE 13
Summary of Differences Between SBC Asserted Labor Rates and Normalized
TELRIC Labor Rate

***CONFIDENTIAL SBC Embedded		Normalized BLS/AT&T	Comments
Wages		***CONFIDENTIAL END CONFIDENTIAL***	Not Adjusted
Hours Per Week		Non-management 40 Management 44.2	BLS data shows managers work 44.2 hours per week
Non-Productive Time		5% of non- management time 5% of management	Not reasonable to assume 100%

***CONFIDENTIAL SBC Embedded		Normalized BLS/AT&T	Comments
		time	productive time
Paid Absence		13.71% (included in overall 49% benefit cost loading)	BLS ECEC report
Special Payment		7.3% (included in overall 49% benefit cost loading)	BLS ECEC report
Wage Increase		None	Offsetting productivity increases not included in SBC studies.
Social Security, Medicare, Pension		17.58% (included in overall 49% benefit cost loading)	BLS ECEC report
Benefits		10.13% (included in overall 49% benefit cost loading)	BLS ECEC report
Other Expenses		.45% (included in overall 49% benefit cost loading)	BLS ECEC report
Support Assets		Up to 76% loading; average 50%.	% of basic wages
Clerical Support		Up to 61.3%; average 8.7%.	% of basic wages
Supervisory Support		Up to 73% loading; average 13%.	% of basic wages
Support/Supervision Other		Up to \$.48 per hour; average \$.02 per hour.	Not Adjusted
Overall Loaded Rate	END CONFIDENTIAL***	Up to 278%, average 220%, factor applied to basic salaries and wages	

1 Q. IN YOUR OPINION, ARE THE ADJUSTED LABOR RATES
2 CONTAINED IN TABLE 12 CONSISTENT WITH A TELRIC
3 METHODOLOGY?

4 A. Yes. The rates I present are normalized for competitive market conditions. The
5 SIC code 48 loadings from the BLS ECEC are a reasonable estimate of

1 competitive market conditions in the telecommunications business. There is little
2 variation in the BLS benefit costs looking at the data historically and looking at
3 other cross sections of the economy. The 49% benefit loading I have adopted for
4 my analysis is the historical high for SIC 48.

5
6 **L. ERRORS IN SBC STUDIES**

7 **Q. HAVE YOU FOUND ANY CALCULATION ERRORS IN SBC'S**
8 **SPREADSHEET FORMULAS?**

9 A. Yes. In file WI14XX00.xls there is a formula inconsistency that I conclude was
10 an oversight on the part of SBC. In all of SBC's other labor rate development
11 studies, when there are supervisory paid absence expenses on the "Loadings"
12 worksheet, these expenses are included in the sum "Salary-Related Support
13 Expense Total." On this particular study, SBC did not include them. In other
14 words, cell D119 should be added to the formula in cell C133. The result is an
15 additional \$3.09 in SBC's asserted labor rate. I recognized these additional
16 expenses in SBC's rates prior to making my normalization adjustments.

17
18 **M. MISSING COST SUPPORT IN SBC STUDIES**

19 **Q. ARE THERE ANY LABOR RATES USED IN SBC'S STUDIES FOR**
20 **WHICH SBC DID NOT PROVIDE LABOR RATE SUPPORT FILES?**

21 A. Yes. SBC did not provide labor rate support files for:

- 22 1. 14XX Senior Analyst – Ohio;
23 2. 14XX Specialist – Ohio;
24 3. 23XX Service Representative – Wisconsin;
25 4. 23XX Service Representative – Illinois; and

1 5. 40XX Provisioning Specialist – Illinois.
2

3 This omission was brought to my attention on April 16th, by which time it was too
4 late to go through the normal discovery process and obtain the support files from
5 SBC.

6 **Q. HOW DID YOU DETERMINE THE NORMALIZED LABOR RATE FOR**
7 **THESE POSITIONS?**

8 A. In its actual UNE service cost studies, as opposed to the labor rate development
9 files, SBC provided what is normally the results page in its labor rate files, Form
10 CRLR5000. I used that information as the basis for my normalization for these
11 five rates. Regarding the two Ohio job positions, SBC had previously provided
12 an OH14XX00.xls file that contained two other Ohio 14XX labor rates. I was
13 able to use the information in the OH14XX00.xls file to gather all the SBC
14 loadings necessary to perform my standard analysis for these two positions.

15
16 For the 23XX Service Representative in Wisconsin, I did not have a
17 WI23XX00.xls file to use. SBC had filed, with cost support, 19 other job
18 categories with a 23XX job function code. For these positions, the average result
19 of my normalization was a 25% reduction in the SBC overall filed rate. I applied
20 this 25% factor to SBC's proposed rate to derive a normalized rate.

21
22 For the 23XX Service Representative – Illinois, I compared the CRLR5000 sheet
23 with the 23XX Market Support Specialist – Michigan, file MI23XX00.xls,
24 CRLR5000 sheet that SBC had previously provided. They were identical.

Therefore, I used the same loadings that were in the Michigan position for my normalization of the Illinois position.

Finally, for the 40XX Provisioning Specialist – Illinois position, I did not have an IL40XX00.xls file to use. SBC had filed, with cost support, 5 other job categories with a 40XX job function code. For these positions, the average result of my normalization was an 18% reduction in the SBC overall filed rate. I applied this 18% factor to SBC's proposed rate to derive a normalized rate.

Q. WHAT IS THE RESULT OF YOUR NORMALIZATION FOR THESE FIVE RATES?

A. The normalized rates for these five positions are shown in the table below.

Table 14
Normalized Rates For Unsupported SBC Filed Rates

***CONFIDENTIAL

	SBC Fully Loaded Rate	Normalized Fully Loaded Rate	% Reduction

END CONFIDENTIAL***

Q. DO YOU BELIEVE THE METHODS YOU HAVE USED TO NORMALIZE THESE RATES THAT WERE FILED BY SBC WITHOUT COST SUPPORT ARE JUST AND REASONABLE?

A. Yes.

1 **IV. SUMMARY AND CONCLUSION**

2 **Q. WOULD YOU PLEASE SUMMARIZE YOUR TESTIMONY?**

3 A. SBC's asserted costs for labor services are not TELRIC compliant. The
4 conservatively high adjustments I propose are necessary to normalize the costs
5 and bring them into compliance with the TELRIC methodology as mandated by
6 the FCC's First Report and Order. Bringing these costs into TELRIC compliance
7 will serve to stimulate competition for local service in Illinois, thereby bringing
8 higher quality, more innovation and lower prices to Illinois consumers.

9 **Q. WHAT ARE YOU ASKING THE COMMISSION TO DO?**

10 A. I strongly urge the Commission to make the conservative adjustments outlined in
11 this testimony to bring the SBC studies into compliance with TELRIC principles.

12 **Q. DOES THAT CONCLUDE YOUR DIRECT TESTIMONY?**

13 A. Yes.